It's a Good Time to Review Your Taxes

With declining occupancies a problem in many areas of the country, along with increasing mortgage interest rates and inflation, it is a good time to review your property taxes and possibly commence a formal appeal to have them reduced. Components such as lower profits and higher cost of capital generally foreshadow lower property values which means that your asessed value might be too high.

Property taxes are levied by municipalities to generate revenues to pay for essential governmental services. The concept of this tax is called "ad valorem," or in proportion to value. The municipal tax burden is allocated on the basis of real estate value; the higher the value of the real estate owned by a property owner, the larger the proportion of the tax burden the individual must assume. To establish the proper distribution of the tax burden, assessors value all the taxable property (real and sometimes personal) within a jurisdiction. Theoretically, the assessed value should bear a definite relationship to market value; properties of equal market values will have similar assessments, and properties of higher and lower values will have proportionally largeror smaller tax assessments.

Your Responsibility

Periodically, assessors review the assessments of the properties within a jurisdiction and make necessary adjustments to the values. Rarely, are these assessed values reduced. It's up to hotel owners to monitor their property assessments to determine when market conditions have adversely affected hotel values, and at that point institute the appropriate appeals process. Factors that can negatively affect hotel values include: overbuilding of competitive hotels, declines in the local, regional or national economy, changes in a property's access and visibility, and items of physical and functional obsolescence. Essentially, anything that could reduce bottom line profits, including higher interest rates, may erode property value.

The first indication that your property assessment may be too high is when the assessed value on a per-room basis is higher than the average assessment on a per-room basis of your immediate competition. Assessed values are public records and owners should stay abreast of the assessments of similar facilities.

The second way to monitor your assessment is to use the following rule-of-thumb assessed value formula: Take the hotel's most recent 12 month operating statement and determine the net income before management fee, after all operating expenses and all fixed expenses such as property taxes, insurance and a reserve for replacement, but before debt service and any non-cash items. Divide this amount by 11 percent and multiply the quotient by 65 percent. For example, a hotel currently has a net income (as calculated above) of \$1,000,000. Its market value for assessment purposes should be roughly: $(\$1,000,000/.11) \times .65 = \$5,900,000$

This value should approximate the market value utilized by the assessor in estimating the assessed value. Remember that some jurisdictions do not assess their properties at full market value, but rather some lesser percentage. This ratio is often called the equalization rate, or the assessed value ratio. In the above example, if the assessed value ratio was 72 percent, the assessed value would be \$4,238,000 $(\$5,900,000 \times .72)$. The taxing jurisdiction should be able to explain to you the relationship between the assessed value and the market value.

Pay Attention

As with any rule of thumb, this procedure provides only a rough approximation of whether the assessed value is reasonable or excessive. Use it only as a possible danger sign to signal the need for further investigation. H

Stephen Rushmore, CRE, MAI, is president of Hospitality Valuation Services, Inc., based in Mineola, New York.